Topic: Difference between Diversion of funds & Siphoning of Funds

1. **Diversion of funds** would be construed to include any one of the undernoted occurrences:
   a. utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
   b. deploying borrowed funds for purposes / activities or creation of assets other than those for which the loan was sanctioned;
   c. transferring funds to the subsidiaries / Group companies or other corporates by whatever modalities;
   d. routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
   e. investment in other companies by way of acquiring equities / debt instruments without approval of lenders;
   d. shortfall in deployment of funds vis-à-vis the amounts disbursed / drawn and the difference not being accounted for.

Here are some of the popular methods that promoters employ to divert the funds.

- **Purchase/Sales of goods to foreign/domestic subsidiaries:**
  Fake accounting entries of purchase and sales are made between group entities without actual transfer of goods or at unusual prices.

- **Loans to foreign/domestic subsidiaries:**
  Money is routed to foreign subsidiaries by giving loans to them and then writing off such loans as non-recoverable. Such subsidiaries lack independent directors and may mostly be in the control of the promoters.

2. **Siphoning of funds** should be construed to occur if any funds borrowed from banks / financial institutions are utilised for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would

have to be a judgement of the lenders based on objective facts and circumstances of the case.

Here are some of the popular methods that promoters employ to siphon off funds.

- **Fake accounting transactions:**
  This is by far the most common route that promoters use to rob their companies. It's also the easiest for promoters as they are the ones responsible for preparing financial statements.
    - Sales or purchase of goods to/from related or known vendors then writing off the receivables.
    - Inappropriate write-offs such as borrowing against receivables.
    - Recognising impairment of subsidiaries, i.e., writing off the money loaned to them.

- **Sale of property:**
  Through this route, promoters/management either buy property that belongs to the company at throwaway prices or use more complicated ways requiring absolutely no money to be spent at their end.

- **Keeping company's assets as collateral**
  The promoter can also get the company to issue comfort letters, post-dated cheques or simply use the company's assets as collateral to take loans from banks and refuse to repay the loan, which leaves the bank with no choice but to take charge of the company's assets or hold the company responsible to repay the loan.

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